Supreme Court, U.S.
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In The Supreme Court of the United States

In Re: Norman W. Shearin, Jr; Ann Shearin,
Debtors.

VANDEVENTER BLACK LLP,
Petitioner,

v.

STEPHEN L. BEAMAN, TRUSTEE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

John M. Ryan
Counsel of Record
VANDEVENTER BLACK LLP
500 World Trade Center
Norfolk, Virginia 23510
(757) 446-8600

Counsel for Petitioner

LANTAGNE LEGAL PRINTING
801 East Main Street Suite 100 Richmond, Virginia 23219 (800) 847-0477

MHPP

QUESTIONS PRESENTED

1. In the Chapter 7 bankruptcy case of an individual partner do the post-petition earnings from services performed by the debtor partner pursuant to an unassumed executory partnership agreement constitute property of the debtor's estate under 11 U.S.C. §541?

2. Do the provisions of 11 U.S.C. §542 require a partnership to turnover partnership assets and property not in the possession of the partnership to the trustee in the Chapter 7 bankruptcy case of a debtor partner?

PARTIES TO THE PROCEEDING

Petitioners

Vandeventer Black LLP, Norman W. Shearin, Jr., and Anne S. Shearin

Respondent

Stephen L. Beaman, Trustee

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OPINIONS BELOW

The opinions of the United States Court of Appeals for the Fourth Circuit in In Re: Shearin are reported at 224 F.3d 346, and 224 F.3d 353. Copies of the Opinions are included in the Appendix at Appendix page 1a and Appendix page 13a. The Orders of the District Court for the Eastern District of North Carolina are included in the Appendix at Appendix page 25a and Appendix page 27a. The Orders of the Bankruptcy Court for the Eastern District of North Carolina are included in the Appendix at Appendix page 28a and Appendix page 40a.

JURISDICTION

The United States Court of Appeals for the Fourth Circuit filed its opinions in companion cases in In Re: Shearin on August 17, 2000. The opinion in Beaman v. Vandeventer Black LLP incorporates and follows the decision in Beaman v. Shearin. A timely filed Petition for Rehearing and Rehearing En Banc was denied on September 12, 2000. This Petition for Writ of Certiorari is filed within 90 days of the denial of the Petition for Rehearing. The court's jurisdiction is invoked pursuant to 28 U.S.C. §§1254(1) and 2106.

STATUTORY PROVISIONS INVOLVED

11 U.S.C. §541 of the U.S. Bankruptcy Code

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c) (2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

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(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

*****

11 U.S.C. §542 of the U.S. Bankruptcy Code

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or value of such property, unless such property is of inconsequential value or benefit to the estate.

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11 U.S.C. §365 of the U.S. Bankruptcy Code

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the

trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

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(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment or rights or delegation of duties, if-

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of right or delegation of duties and

(B) such party does not consent to such assumption or assignment; or

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(d) (1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, or cause, within such.

STATEMENT OF THE CASE

On July 12, 1996 Norman W. Shearin, Jr. and Anne S. Shearin, ("the Debtors") filed a voluntary petition for relief under Chapter 7 ("the Petition"). Stephen L. Beaman was appointed Trustee (the "Trustee"). Norman W. Shearin, Jr. ("Shearin") is an attorney and partner in the law firm of

Vandeventer Black LLP, a Virginia limited liability partnership. ("the Partnership").

Following the Debtors' bankruptcy filing the remaining partners in the Partnership continued its law practice under a partnership agreement dated January 1, 1996 ("the Partnership Agreement"). Shearin continued to perform services for the Partnership and received compensation for his personal services in the form of bi-monthly, quarterly and year-end distributions.

Under the Partnership Agreement, partners are only entitled to bi-monthly draws and possess no interest in distributable net profits until such profits, if any, are determined by the Management Committee of the Partnership at year-end. Consequently, on the Petition date Shearin had no interest in the undistributed profits of the Partnership.

At 1996 year-end, the Management Committee of the Partnership divided its distributable net profits in accordance with the Partnership Agreement. Shearin received two checks - one in December of 1996 in the amount of $62,494.00, and another in January 1997 in the amount of $17,976.58.

The Partnership Agreement requires that the Partnership maintain a capital account for each partner in the form of an entry on its books. The entry states the amount of capital contributed by each partner. As of the date of the Petition, Shearin had no right under the Partnership Agreement to demand or receive payment of his capital account.

On March 18, 1997, when the turnover proceeding was commenced, the Partnership did not possess any pre-petition earnings of Shearin for calendar year 1996 or the cash contributed by Shearin as capital to the Partnership.

REASONS FOR GRANTING THE PETITION

In companion cases, the United States Court of Appeals for the Fourth Circuit held that post-petition earnings from Shearin's personal services and Shearin's capital account in the Partnership were property of the Debtors' estate. One of the decisions also ordered the Partnership to turnover to the Trustee partnership profits distributed to Shearin post-petition in payment for his personal services, and a partnership asset, capital contributed to the Partnership by Shearin, which were not in the possession of the Partnership.

The Questions Presented in these companion cases permit the Court to provide timely and necessary guidance regarding two overarching and conflicting purposes of the Bankruptcy Code generally, and 11 U.S.C.§541 specifically: "(1) providing protection for the creditors of the insolvent debtor and (2) permitting the debtor to carry on and rebuild his life, that is, to make a fresh start." In re Andrews, 80 F.3d 906, 909 (4th Cir. 1996). As stated in In re Andrews, supra at 910:

> The second purpose finds expression in the bright line the Bankruptcy Court draws between pre-and post-Bankruptcy filing

> events. Thus, §541(a)(1) provides that the estate includes the debtor's legal and equitable interest "as of the commencement of the case," and leaves the bankruptcy debtor free after that date to accumulate new wealth so that he might make a fresh start following bankruptcy. Similarly, the provision at issue here, §541(a)(6), allows the debtor to exclude from his estate any compensation or salary he might earn after the date of the petition.

These conflicting purposes of the Bankruptcy Code are to be reconciled by the bright line between pre-and post-petition assets. Id. At 910. By holding the post-petition distributions to Shearin of his earnings from services performed for the Partnership are property of the estate, the United States Court of Appeals for the Fourth Circuit ignored that bright line and disregarded the specific exclusion from property of the estate in 11 U.S.C.§541(a) (6) for post-petition earnings. As the Fourth Circuit notes in In re Andrews, supra at p. 910, the U.S. Supreme Court has acknowledged this bright line in Segal v. Rochelle, 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966). [1]

The Questions Presented also allow the Court to resolve a conflict which now exists between the present case and another recent case decided by the United States Court of Appeals for the Fourth Circuit, Hager v. Gibson, 109 F.3d 201 (4th Cir. 1997). Review of the present case will also

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[1] Although Segal predates the Bankruptcy Reform Act of 1978, the Fourth Circuit acknowledges in In Re Andrews, supra at fn. 9 that "...the legislative history of the Bankruptcy Reform Act of 1978 indicates that the result in Segal remains valid under the current Bankruptcy Code."

permit the Court to resolve the conflict between Hager v. Gibson and the decision of the United States Court of Appeals for the Seventh Circuit, Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, PA, (In re U.S.A. Diversified Products, Inc.), 100 F.3d 53 (7th Cir. 1996) ("Diversified"). The Seventh Circuit in Diversified also ordered a partnership to turnover property which was not in the possession of the partnership to a trustee in the bankruptcy of a Chapter 7 debtor.[2] The Fourth Circuit says in Hager v. Gibson, supra at pp. 210-211, that the correct statement of the law is set forth in Maggio v. Zeitz, 333 U.S. 56, 64, 68 S.Ct. 401, 405-406, 92 L.Ed.476 (1948). Accordingly, the holding in the present case also conflicts with the Supreme Court decision in Maggio v. Zeitz.

In resolving these conflicts the Court must also examine and interpret the relevant provisions of 11 U.S.C. § 365 regarding the legal authority of a trustee in bankruptcy to assume executory contracts such as the Partnership Agreement.

These issues have great significance in bankruptcy administration. Moreover, none of these issues has been addressed by the Court since the enactment of the Bankruptcy Reform Act of 1978. Consequently, guidance

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[2] See the dissenting opinion of Judge Wilkins in the Court of Appeals decision in Beaman v. Vandeventer, in the Appendix at pages 19a-22a, which acknowledges the conflict with Hager v. Gibson, 109 F.3d 201 (4th Cir. 1997). Judge Wilkins also cites 3 William L. Norton, Jr., Norton Bankruptcy Law and Practice §52:4, at 6n. 12.5(Supp. 2000) which notes the conflict between Hager and In re Diversified Products, Inc., 100 F.3d 53 (7th Cir. 1996).

by the Court as to the interpretation and application of the relevant statutory provisions is warranted.

Under 11 U.S.C.§541(a)(1) of the Bankruptcy Code, the trustee of the bankruptcy estate succeeds only to those interests that the debtor had in property prior to commencement of the bankruptcy case. In re FCX, Inc., 853 F.2d 1149, 1153 (4th Cir. 1988). "[W]hatever rights a debtor has in property at the commencement of the case continue in bankruptcy-no more, no less." Id. at page 1153.

The existence, nature and extent "of a debtor and hence the estate's, interest in property must be determined by resort to non-bankruptcy law-usually state law." In re FCX, Inc., supra at p. 1153. At the time of the filing of the Petition, the year-end distributions of the Partnership were prospective earnings. Under applicable North Carolina law, prospective earnings of a debtor are not property. Motor Finance Co. v. Putnam, 229 N.C. at 557, 50 S.E. 2d at 671(1948); Harris v. Hinson, 87 N.C. App. At 650, 360 S.E. 2d at 120 (1987).

Moreover, the Court stated in Segal v. Rochelle, 382 US 375, 379-380, 86 S.Ct.511, 515, that there are limitations on what is property for purposes of the Bankruptcy Act. One such "purpose, which is highly prominent and is relevant, is to leave the bankrupt free, after the date of his petition, to accumulate new wealth in the future. Accordingly future wages of the bankrupt do not constitute "property" at the time of the bankruptcy..."

The capital of a partnership is an asset of the partnership and not of an individual partner. 59A Am.Jur.2d

Partnership §333 (1998). An individual partner has no right to a return of capital but only to the value of his share of the profits and surplus, if any, remaining after a full accounting or settlement of partnership affairs. Summerson v. Donovan, 110 Va. 657, 66 S.E. 822 (1910), 59A Am.Jur.2d Partnership §979 (1998).

The Partnership Agreement does not afford a partner any rights whatsoever in a capital account or other partnership assets in the event of bankruptcy. Virginia partnership law does not afford a bankrupt partner any interest in a capital account.

Shearin could not demand and receive his capital account or his future earnings on the date he filed the Petition. The Trustee did not acquire rights in bankruptcy that Shearin did not have when he filed the Petition. In re FCX, Inc., supra at p. 1153.

The bankruptcy of a partner causes a dissolution of the partnership. Va. Code Ann. § 50-31(5); Woodson v. Gilmer, 205 Va. 487, 137 S.E.2d 891 (1964); 1MWA Equities IX Co. v. WBC Associates Limited Partnership, 961 F.2d 480 (4th Cir. 1992). A partnership is not terminated by dissolution but continues until the winding up of the partnership affairs is completed. Va. Code Ann. § 50-30; In re 2111 Associates - Chicago, 580 F.2d 705 (4th Cir. 1978). Actual termination of the partnership under Virginia law occurs only after the assets held in the partnership are distributed and accounts between partners are settled. FDIC v. Hish, 76 F.3d 620 (4th Cir. 1996).

However, a liquidation of partnership assets is not required under Virginia law where the dissolution is caused by the bankruptcy of a partner. Id. at p. 623, fn. 2. The remaining partners may agree to continue the partnership business. Id. at p. 623, fn. 2. Title to partnership assets vested in the dissolved partnership "shall be deemed to be transferred to and vested in such new partnership." Id. at p. 623, fn. 2; Va. Code Ann. § 50-37.1 (Michie 1950).

Under Virginia law, a partner's interest in a partnership is his share of the profits and surplus. Va. Code Ann. § 50-26 (Michie 1950); In re Decker, 295 F.Supp. 501 (W.D. Va. 1969), aff'd. 420 F.2d 378 (4th Cir. 1970). Therefore, Shearin's interest in the Partnership at the commencement of his bankruptcy case on July 12, 1996, was his share of the profits and surplus, if any, on that date remaining after an accounting and payment of partnership debts. Therefore the only interest that the Trustee has in the present case is Shearin's partnership interest on July 12, 1996. In re FCX, Inc., 853 F. 2d 1149(4th Cir. 1988).

Assets such as capital contributed by a partner and owned by a partnership are not included in the bankruptcy estate of an individual partner. The only property or asset before the bankruptcy court in an individual partner's bankruptcy is the partner's personal property interest in the partnership.

The Trustee cannot "use, sell or lease" Shearin's partnership interest as required by 11 USC §542 (a). The Trustee can only use "the funds" which he alleges represent the value of the capital account and the year-end

distributions made to Shearin. Only by converting Shearin's partnership interest into money in a partial liquidation of partnership assets can the Trustee "use" Shearin's partnership interest.

The case of In re Cutler, 165 B.R. 275 (Bankr. D. Ariz. 1994) discusses the relevant issues and holds that a Chapter 7 trustee in an individual partner's bankruptcy has no right to force the liquidation of partnership assets. The court says that the trustee may sell the bankrupt partner's partnership interest. However, the trustee in bankruptcy does not acquire jurisdiction of the partnership property for purposes of winding up the affairs of the partnership. The court states that to allow the trustee to liquidate the underlying assets of the partnership would be to grant to him management prerogatives where he has none. To have such management prerogatives, the trustee would have to assume the partnership contract. However, that is legally impermissible in a Chapter 7 case since 60 days have passed after the order for relief, resulting in an automatic rejection under Section 365(d) (1). In addition, Section 365(c) (1) prohibits assumption by the trustee.

An accounting or settlement of the partnership affairs is a condition precedent to a suit for a money judgment by a partner against his partnership. 1MWA Equities IX Co., supra at p. 482; Summerson v. Donovan, supra; 59A Am.Jur.2d Partnership §542 (1998). The right of the trustee in bankruptcy as the legal representative of the bankrupt partner to an accounting accrued on the date of dissolution, i.e. upon the filing of the Petition by the Debtors on July 12,

1996. Va. Code Ann. § 50-43 (Michie 1950); Jordan v. Bowman Apple Products Co., Inc., 728 F.Supp. 409, 417-418 (W.D.Va. 1990). Nevertheless, the Trustee has not yet sought or obtained an accounting. Instead the Trustee sued the Debtors and the Partnership to recover money judgments which represent the "value" of specific partnership assets, and year-end profits of the Partnership which continued the business of the dissolved partnership.

The absence of an accounting notwithstanding, the Court of Appeals for the Fourth Circuit affirmed a money judgment which ordered the Partnership "to turnover funds in the amounts of $28,844.10 and $52,133.64." The Partnership was held liable for these sums under Section 542(a) of the Bankruptcy Code, which imposes a duty on those holding property of the estate to turnover that property to the Trustee, even though the Partnership was not in possession of those funds.

In ordering the Partnership to pay these sums, the Court of Appeals declined to follow existing case law in the Fourth Circuit and the Supreme Court, and instead followed Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler (In re U.S.A. Diversified Products, Inc.), 100 F.3d. 53 (7th Cir. 1996). ("Diversified"). The Court acknowledges Hager v. Gibson, 109 F. 3d 210 at 211 (4th Cir. 1997) and implies that Hager can be distinguish based on the fact that Hager disposed of the money in question pre-petition.[3]

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[3] See the dissenting opinion of Judge Wilkins in Appendix at p. 22a. The Fourth Circuit in Hager does not even mention the fact that Hager received and disposed of estate property pre-petition as being relevant or material to the ruling as to the turnover provisions of §542(a).

In Hager, an opinion by Judge Phillips, the Fourth Circuit says that "Hager contends that this section [542(a)] does not authorize recovery.... because he was not, when the adversary proceeding was brought, an entity in possession, custody or control during the case of the property. We agree. Present possession, either actual or constructive, of the property or its identifiable proceeds by the person from whom its turnover is sought, is required for recovery under this section." Hager at p. 210. As the opinion in Hager states, present possession by the person from whom turnover is sought when the adversary proceeding was brought is required for recovery.

Moreover, the facts in the Seventh Circuit decision in Diversified are dramatically different than the facts of the present case. In Diversified the law firm received $125,000 in trust account funds from a corporate client. The next day the corporate client filed bankruptcy. Four days later the law firm was informed of the corporate client's bankruptcy filing. Two months later the law firm paid trust account funds to one of the principals in the corporation.

The law firm in Diversified paid trust account funds to the wrong party. Id. at p. 874, fn. 5. As the court stated in Diversified "the state law principles concerning funds held in an attorney's trust account are so fundamental that they are not questioned. Property held in an attorney's trust account belongs to the client and the attorney is required to deliver that property to the client upon request." Id. at p. 873, fn. 4. The payment was wrongfully made to a third party in breach of fiduciary duties which the law firm owed

its corporate client. Id. at p. 875, fn. 6.[4] On these facts the law firm was ordered by the court to pay the value of the funds to the trustee.

Unlike Diversified the sums paid to Shearin by the Partnership in the present case were not in the Partnership's possession when Shearin filed bankruptcy. The funds held by the Partnership belonged to the Partnership until those funds were paid to Shearin. The funds did not become Shearin's property until he received them.

The money judgment was entered notwithstanding the undisputed fact that the Partnership was not in possession of the funds paid to the male debtor or capital contributions made to the Partnership by him on either the date of the Petition or the date of the commencement of the turnover proceeding by the Trustee.

CONCLUSION

Manifestly, Shearin had no right under the Partnership Agreement to demand and receive his capital account or his future earnings on the date he filed the Petition. The Trustee did not acquire rights in bankruptcy

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[4] Payment by a fiduciary of the debtor to a third party in breach of the fiduciary relationship is a well recognized exception to the general rule that property subject to turnover must be in possession of the person from whom turnover is sought. E.g. May v. Henderson, 268 U.S. 111, 45 S.Ct. 456, 67 L. Ed. 870 (1925); In re Gailey, Inc., 119 B.R. 504, 514 (Bankr. W.D. Pa. 1990); Yacquinto v. Greer, 81 B.R. 870, 877-878 (Bankr. N.D. Tex 1988); In re DeBerry, 59 B.R. 891, 896 (Bankr. E.D. N.Y. 1986); In the Matter of Cafes International, Ltd., 13 B.R. 155, 160-161 (Bankr. S.D.N.Y. 1981)

that Shearin did not have when he filed the Petition. In re Lyons, 957 F.2d. 444, 445 (7th cir. 1992). The decisions of the Court of Appeals have accorded the Trustee rights more expansive than any rights which Shearin had at the time of his bankruptcy filing or which any partner in the Partnership has under the Partnership Agreement. No other reported case holds that an individual partner's capital account is property of a debtor's estate. The effect of the decisions are as if the Trustee had assumed the Partnership Agreement, an executory contract, in order that he receive financial benefits under it. The decisions ignore the fact that the Trustee did not assume the Partnership Agreement and is prohibited by 11 U.S.C. Section 365(c)(1) from doing so.

By holding that the post-petition distributions to Shearin of his earnings from services performed for the Partnership were property of the Debtors' estate, the decisions ignored the bright line between pre- and post-petition assets and disregard the specific exclusion from property of the estate in 11 U.S.C.§541(a)(6) for the post-petition earnings of Shearin for his personal services to the Partnership.

There is no precedent which supports the imposition of liability on the Partnership for the payment of the Partnership's own funds to Shearin. Moreover, the decision of the Court of Appeals conflicts with the decision of the Supreme Court in Maggio v. Zeitz, supra and the Fourth Circuit in Hager v. Gibson, supra holding that present possession is required for turnover. When the Trustee commenced this turnover proceeding on March 18, 1997, the

Partnership's funds representing year-end distributions had already been paid to Shearin. The funds provided by Shearin as capital to the Partnership had already become a partnership asset and been spent. As a result, the Partnership no longer had possession of the funds which are the object of the money judgment entered against the Partnership.

This the 11TH day of December, 2000.

Respectfully submitted,

John M. Ryan
VA. State Bar No. 4301
VANDEVENTER BLACK LLP
Attorney for Petitioners
500 World Trade Center
Norfolk, VA 23510
Telephone: (757) 446-8600